



GERALD A. SILVA
City Auditor

CITY OF SAN JOSÉ, CALIFORNIA

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SAN JOSE, CALIFORNIA 95110
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January 5, 1988

Honorable Mayor and Members
of the City Council
801 North First Street, Room 600
San Jose, CA 95110

Transmitted herewith is a report on *A Compliance Review of the City's Investment Activities*. This report is in accordance with City Charter Section 805(a).

An Executive Summary is presented on the blue pages in the front of this report while an Administration response (Finance Department) is shown on the yellow pages before the Appendices.

I will present this report to the Finance Committee at its January 20, 1988 meeting. If you need additional information in the interim, please let me know. City Auditor staff who participated in the preparation of this report are Joe Morical and Dominador Melendez.

Respectfully submitted,

Gerald A. Silva
City Auditor

EXSUM052
GS:mlt

cc: Susan George, Deputy City Manager/Director of Finance
Deborah Kelley, Chief of Treasury
Joan Gallo, City Attorney



*OFFICE OF THE
CITY AUDITOR*

**A COMPLIANCE REVIEW
OF THE
CITY'S INVESTMENT ACTIVITIES**

*A REPORT TO THE
SAN JOSE
CITY COUNCIL*

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EXECUTIVE SUMMARY

This is the eighth in a series of reviews we have performed to assess the City's and Agency's investment activities and their compliance with investment policy. These reports contain a total of thirty recommendations designed to enhance compliance with Policy provisions and improve the investment programs. This report contains a summary of the improvements made over the last two years and the results of our current review of investment transactions for December 1986 and January and July 1987. The following activities were reviewed:

*December 1986, January 1987, and July 1987
Compliance Review - One Exception Noted*

Our review of investment transactions for the City and the Redevelopment Agency for December 1986, January 1987, and July 1987 indicates that Finance has generally complied with Investment Policy requirements. We did note one exception relative to under-collateralizing a Redevelopment Agency repurchase agreement. Noncompliance continues in areas which require more in-depth staff work and legal assistance. These areas include evaluating dealer financial condition and executing formal master repurchase and safekeeping agreements. Finally, improvements in documentation and control procedures are occurring. Appendix A contains a complete summary of the results of this review.

FOLLOW-UP ON PRIOR RECOMMENDATIONS

In prior reviews, the City Auditor has developed a number of recommendations to enhance compliance with the City's Investment Policy and improve both the City's and the Redevelopment Agency's investment programs. Our review of investment transactions for December 1986 and January and July 1987 indicates that Finance is taking steps to comply with prior compliance review recommendations. Of the thirty recommendations contained in our reviews over the last two years:

- Twenty-four have been fully implemented,
- Two are combined with other recommendations (one has been fully implemented),
- One is implemented but the procedure needs improvement, and
- Three are in progress.

A complete summary of the implementation status of prior recommendations is contained in Appendix B.

RECOMMENDATIONS

We recommend that:

Recommendation #1:

Finance establish a procedure for the safekeeping bank to confirm with the Treasury Division the amount and type of collateral received for repurchase agreements.

BACKGROUND

After the bond loss in May 1984, the Administration took several major steps to improve the management and operation of the City and the Redevelopment Agency investment programs. Specifically, the Department of Finance prepared a new Investment Policy which the City Council adopted on April 2, 1985 and the Department established procedures to carry out the Policy requirements. In addition, Finance changed the format and content of the monthly investment reports to more effectively convey results of investment activities. Also, Finance and the Redevelopment Agency prepared cash flow forecast reports to assist in day-to-day investment decisions. Further, the Administration's Internal Investment Committee was revived and a Private Sector Investment Panel was created. Finally, the Administration hired a new Finance Director and a new Chief of Treasury.

Because of the critical importance of carefully monitoring the investment program, the Council Finance Committee directed the City Auditor to conduct monthly compliance reviews of the City's and Agency's investments. These reviews assessed compliance with Investment Policy requirements and general program controls, such as safekeeping of securities and documentation of investments. Since the Fall of 1985, the City Auditor has issued seven reports assessing the Finance Department's compliance with the Investment Policy. These reports contain a total of thirty recommendations designed to enhance compliance with the Policy

provisions and improve the investment programs. The reports covered investment transactions for: September 1985, October 1985, November/December 1985, January/February 1986, March/April 1986, May/June 1986, and July/August 1986. The current report covers December 1986 and January and July 1987.

The Finance Department and the City Auditor's Office have put a significant amount of time and effort into these reviews. While the Finance Department has been taking steps to implement and comply with all audit recommendations, the City Auditor's Office, by Council directive, has continued conducting Investment Compliance Reviews and following up on prior recommendations. Much progress has been made over the last two years as is evidenced by our latest review.

We have included, as Appendix B, a chart containing a listing of our findings from all prior reports and the status of corrective action. The findings can be divided into three basic categories which are summarized below.

SAFEKEEPING/LEGAL

Finance has made significant progress in implementing audit recommendations needed to improve compliance with Policy provisions designed to mitigate risks and enhance safety of City and Redevelopment Agency investments. Treasury has established and

maintained adequate procedures to comply with the Policy collateralization provisions, ceased repurchase agreements with banks which also act as our safekeeping agents, and prepared a compilation and analysis of State and Federal laws applicable to investment programs. Furthermore, Treasury began routine evaluations of dealers' financial conditions in November 1987. However, the target of December 31, 1987 for the execution of formal master repurchase agreements was not met because dealers have been reluctant to accept all provisions of the agreement.

In August 1986, the City also implemented a new banking services agreement which includes safekeeping provisions. The Redevelopment Agency, on the other hand, has not executed a new banking services agreement as of the date of this report.

PROCEDURAL/OPERATIONAL

The audit recommendations that fall under this category deal with refinements needed to provide timely and accurate information for the management and oversight of the investment portfolios. To ensure that controls are functioning as intended, Finance has established additional procedures and issued specific instructions. For instance, Treasury is now following a procedure to ensure that confirmations to banks, dealers and safekeeping agents are prepared, signed, and mailed within five working days as prescribed by the Policy. Also, a system is now in place to ensure compliance with criteria

regarding instrument type and rating, issuer's rating, and diversification limits. For example, Treasury now inputs all investment information into the MONEymax system on the transaction settlement day so that Investment staff and management will have accurate daily portfolio profiles. Furthermore, the monthly investment report has been improved to include information regarding dealer's name, investments which do not conform with Investment Policy, and other technical exceptions.

DOCUMENTATION

Documentation of processes, transactions, procedures and policy interpretations has contributed significantly to improving management control over investment activities and decisions. For example, on any given day, management can review the portfolio profile, determine how funds invested have been calculated, obtain information about dealers and the rates they offer, and evaluate the investment decision made and the securities bought and/or sold. Treasury also has facilitated accounting for the confirmation documents used for the purchase and/or sale of investments by generating computerized pre-numbered forms. Moreover, because MONEymax procedures have been simplified and documented, it is now easier to train employees on using the MONEymax System. While this will hopefully enhance productivity, scheduled periodic reviews of the operations manual are still needed to formally update the procedures. Finally, documented

interpretations of Policy provisions have reduced the risk of inadvertent policy noncompliances and provided increased investment program consistency.

SCOPE AND METHODOLOGY

We reviewed the City and the Redevelopment Agency investment transactions for the months of December 1986, January 1987, and July 1987 to determine compliance with the Investment Policy. Also, we reviewed Treasury files, records and reports for appropriate documentation and processing of transactions. Finally, we followed up on the status of the prior compliance review recommendations.

To evaluate compliance, we sampled each month's transactions and tested each sample item for proper instrument type, rating, maturity, diversification limits and where applicable, adequacy of collateralization. In addition, our review covered other compliance requirements such as: safekeeping, dealer pre-qualification, timeliness of written confirmations, wire fund transfer controls, and exception reporting. Furthermore, we reviewed files and records to determine whether confirmation documents were matched with the bank/dealer advices on a timely basis and whether transactions were recorded promptly in the MONEYMAX system and reported accurately. Finally, we interviewed Treasury staff and verified documentation, where needed, to follow up on the implementation status of prior recommendations.

FINDING I

DECEMBER 1986, JANUARY 1987, AND JULY 1987 COMPLIANCE REVIEW - ONE EXCEPTION NOTED

Our review of investment transactions for the City and the Redevelopment Agency for December 1986, January 1987, and July 1987 indicates that Finance has generally complied with Investment Policy requirements. We did note one exception relative to under-collateralizing a Redevelopment Agency repurchase agreement. Noncompliance continues in areas which require more in-depth staff work and legal assistance. These areas include evaluating dealer financial condition and executing formal master repurchase and safekeeping agreements. Finally, improvements in documentation and control procedures are occurring. Appendix A contains a complete summary of the results of this review.

Purchases

In January 1987, a Redevelopment Agency repurchase agreement was significantly under-collateralized for three days. On Friday, January 2, the dealer delivered \$3,136,000, instead of \$4,191,000 worth of collateral securities for a \$4,142,000 repurchase agreement. The safekeeping bank did not detect the error until the Fed Wire closed that day. As a result, the repurchase agreement was under-collateralized by \$1,006,000 until it matured the following Monday, January 5, 1987. Treasury discussed the problem with the dealer and the

safekeeping bank to prevent a recurrence of the problem. This exception was also subsequently reported in the January 1987 Monthly Investment Report.

Except for the under-collaterization discussed above, our review of investment transactions indicates that Finance complied with Investment Policy purchasing requirements during December 1986, January 1987, and July 1987.

Dealer Prequalification

The City has generally complied with Policy requirements for dealer pre-qualification. In November 1987, Treasury staff plan to start evaluating regularly the dealers' financial condition. Treasury has already drafted procedures for the dealer pre-qualification process. Finance mailed the final master repurchase agreement documents to the dealers on October 2, 1987. As of December 3, 1987, 10 out of 31 dealers responded. All of the responses have comments that need to be reviewed by the City Attorney.

Portfolio Mix

Our review indicated that Finance complied with Policy requirements for limiting portfolio diversification to specific percentages or amounts applicable to each investment category, instrument type, and issuer.

Safekeeping

On August 27, 1986, the City entered into an agreement for banking services with Security Pacific National Bank. This agreement includes provisions for safekeeping services. The Redevelopment Agency, however, has not provided any target date for implementing a safekeeping agreement with its bank.

Our review indicated that the Accounting Division is reconciling safekeeping and dealer documents to Accounting's copy of Treasury's confirmation document. Also, Accounting follows up on confirmations and receipts not received within ten days of settlement. However, no documentation was available to verify the follow-ups were made.

Other Procedures/Controls

Treasury has made some improvements in the documentation of cash flow forecast information. However, the accuracy of the documentation for the purpose of third party review is still limited.

During our review of December 1986 and January 1987 transactions, we noted that Redevelopment Accounting was not always date stamping bank/dealer advices. Of the fifteen bank/dealer advices sampled, four were not date stamped as

required. Finance has taken steps to improve the procedure as evidenced by the result of the July 1987 review. This review indicated that only one dealer confirmation out of nineteen sampled was not date stamped, and one safekeeping release for a one-day repurchase agreement transaction that matured on July 21, 1987 was not on file.

FOLLOW-UP ON PRIOR RECOMMENDATIONS

In prior reviews, the City Auditor has developed a number of recommendations to enhance compliance with the City's Investment Policy and improve both the City's and the Redevelopment Agency's investment programs. Our review of investment transactions for December 1986 and January and July 1987 indicates that Finance is taking steps to comply with prior compliance review recommendations. Of the thirty recommendations contained in our reviews over the last two years:

- Twenty-four have been fully implemented,
- Two are combined with other recommendations (one has been fully implemented),
- One is implemented but the procedure needs improvement, and
- Three are in progress.

A complete summary of the implementation status of prior recommendations is contained in Appendix B.

CONCLUSION

Except for one instance where a Redevelopment Agency repurchase acquisition was significantly under-collateralized, our review of December 1986 and January and July 1987 indicated general compliance with the City Investment Policy. Finance continues implementing prior audit recommendations. Of thirty recommendations, twenty-four are fully implemented and one of the two recommendations that were combined with other recommendations has also been implemented. The remaining four recommendations are in various stages of implementation.

RECOMMENDATIONS

We recommend that:

Recommendation #1:

Finance establish a procedure for the safekeeping bank to confirm with the Treasury Division the amount and type of collateral received for repurchase agreements.

CITY OF SAN JOSE - MEMORANDUM

TO: Honorable Mayor and
City Council

SUBJECT: RESPONSE TO INVESTMENT
COMPLIANCE REVIEW

FROM: Susan E. George
Director of Finance

DATE: December 21, 1987

APPROVED

DATE

BACKGROUND

As described in the Auditor's review, the Finance Department has made significant progress in implementing all of the recommendations developed continuously during the past 2 1/2 years. In addition, Investment staff continues to undergo training in systems and concepts to ensure the propriety of investment decisions as well as to keep staff abreast of current developments. For example, the Treasury Assistant obtained professional certification in the area of cash management in July 1987, a very positive result of the environment created in this maturing program.

The following discussion will focus on the recommendation formulated as part of this most recent compliance review. Finance agrees with the recommendation in concept, but feels the procedures currently in place should satisfy the Auditor's concerns in the most pragmatic manner.

DISCUSSION

The Auditor mentioned that Treasury responded to the undercollateralized repurchase agreement which the safekeeping bank erroneously allowed to settle on January 2, 1987. For reference, copies of the letters to First Boston Corporation and Bank of America are attached as Exhibits 1 and 2 respectively. Exhibit 3 is the apologetic response from Bank of America. In addition, staff highlighted the exceptional situation in the January 1987 monthly investment report for the Redevelopment Agency.

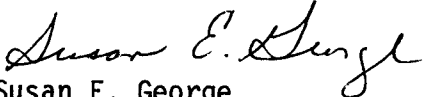
It is important to note that the Bank of America will no longer provide safekeeping and transaction clearing services after the process of merging of the City and Redevelopment Agency portfolios is complete. The target date for the related transfer of the Redevelopment Agency's securities to Security Pacific National Bank is January 4, 1988. This means that the procedure recommended by the Auditor would have to be implemented through Security Pacific. Security Pacific is currently set up to contact the City whenever the collateral presented by any dealer differs from the collateral staff authorizes the bank to accept, which is standard industry practice. Except for the problem in January, Bank of America's procedures were the same and were routinely followed. The significant difference between the clearing services provided by Bank of America and Security Pacific is that the former institution's procedures have not been contractually secured.

RECEIVED
DEC 29 1987

CONCLUSION

Staff feels the absolute rarity of this type of safekeeping bank performance failure does not warrant the recommended additional City and bank administrative effort in the form of daily confirmations of collateral receipt. Maintaining the industry practice of notice on an exception basis only through Security Pacific should satisfy the intent of the recommendation, particularly since similar transactions have been problem-free with this institution to date. Therefore, the Finance Department must respond by stating that reasonable procedures have already been established and that the recommendation has been implemented.

Respectfully submitted,


Susan E. George
Director of Finance

SEG:DSK:bm
2394F/0145F



CITY OF SAN JOSÉ, CALIFORNIA

ROOM 217, CITY HALL
801 NORTH FIRST STREET
SAN JOSE, CA 95110-1708

TELEPHONE NUMBERS (Area Code 408)
Banking & Investments 277-4181 Account Receivable 277-4184
Licenses & Permits 277-5051 Sewer Service Billings 277-5195

January 20, 1987

FINANCE DEPARTMENT
Treasury Division

First Boston Corp
Attention: Q Belk
101 California St.
Suite 4300
San Francisco, CA 94111

RE: Undercollateralized Repurchase Agreement

Dear Q:

As you are aware, we require all repurchase agreements to be collateralized at 102% (or more) of the dollar amount invested. However, when we did a \$4,142,000 repurchase agreement with you on January 2 for our Redevelopment Agency, you pledged collateral valued at approximately \$4,191,283 (\$3,970,000 USTN 7.50% of 8/15/91). Using this instrument meant we would be collateralized at only 100.95%. Because you were unable to tell us what collateral you would provide until after 10 AM PST, we did not ask for additional collateral in order to notify the Agency's safekeeping bank of the repurchase agreement before the bank's cutoff time.

However, your firm delivered only \$2,970,000 of this instrument. The Agency's bank accepted delivery and notified my office of the shortage. Investment staff attempted to call your office, but were told that everyone had left for the day. Although you later returned the call, it was too late in the day to transfer additional collateral, leaving the Agency's investment severely undercollateralized over the weekend.

To prevent a similar problem from occurring in the future, we ask your cooperation in two ways. First, please select the collateral you propose to use carefully to insure that it will provide sufficient coverage. Second, please try to tell us earlier in the morning exactly what collateral you will provide. Earlier notification will allow time for City investment staff to verify the value of the proposed collateral, to ask for additional collateral if necessary, and to notify the appropriate safekeeping bank before the deadline.

We value the professional relationship we have established with your firm and look forward to continued business in the future. However, collateralization problems such as described above cannot be tolerated. We would appreciate receiving your assurance that this problem will not occur again.

Sincerely,

Deborah S. Kelly
Chief of Treasury

DSK:JB:bc

cc: Edward G. Schilling
Jessica Batinich ✓

EXHIBIT 1



FINANCE DEPARTMENT
Treasury Division

CITY OF SAN JOSE, CALIFORNIA

ROOM 217, CITY HALL
801 NORTH FIRST STREET
SAN JOSE, CA 95110-1708

TELEPHONE NUMBERS (Area Code 408)
Banking & Investments 277-4181 Account Receivable 277-4184
Licenses & Permits 277-5051 Sewer Service Billings 277-5195

January 29, 1987

Mr. Brian Hagland, Supervisor
Bank of America NT & SA
Securities Clearance Services #3298
555 California St./Concourse Level
San Francisco, CA 94104

Re: Redevelopment Agency of the City of San Jose
Safekeeping Account #325912
Undercollateralized Repurchase Agreement

Dear Mr. Hagland:

On January 2, 1987, the Redevelopment Agency entered into a three-day repurchase agreement with First Boston Corp for \$4,142,000. Your office was instructed to accept delivery of \$3,970,000 U.S. Treasury Notes, 7.50%, maturing August 15, 1991.

However, when First Boston attempted to deliver only \$2,970,000 of this instrument, your office accepted delivery of the short amount without notifying Redevelopment Agency investment staff. The Agency was not notified of the shortage until after the Fed wire was closed, at which point it was too late to ask First Boston to send additional collateral.

It has been our understanding that your office would not accept delivery of securities that differed in any way from the instructions you were given by our investment staff. While we understand that errors may occasionally occur, this error caused the Agency's investment to be seriously undercollateralized over a weekend.

We would appreciate your assurance that this type of problem will not occur again. Also please instruct your staff to call the Agency's investment staff immediately whenever there is a delivery problem. Prompt notification to Agency staff will enable them to research and possibly resolve the problem quickly.

Sincerely,

Deborah S. Kelly
Chief of Treasury

DSK:JB:hc
cc: E. Schilling

EXHIBIT 2



Bank of America

Securities Clearance Services

*Received 2/13/87
copy to Debbie
file original*

February 6, 1987

Ms. Deborah S. Kelly
Chief of Treasury, Finance Dept.
Room 217 City Hall
801 North First Street
San Jose, CA 94104

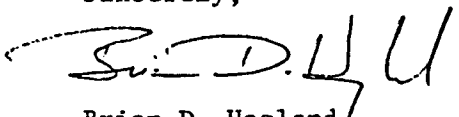
Dear Ms. Kelly:

I would like to take this opportunity to respond to your letter of January 29, 1987 concerning your January 2, 1987 repurchase agreement with First Boston Corp.

It has always been the established procedure of the securities clearance staff to immediately notify the safekeeping clearance customer when securities are delivered contrary to the exact instructions given us by the customer. Unfortunately, in this instance the incoming Fed desk had an exceptionally heavy settlements day and the error was not detected until after the Fed wire closed. Nevertheless, the error should not have occurred and I sincerely regret that this error caused the Redevelopment Agency's investment to be undercollateralized.

Please be assured that the responsible employee has been counseled in this matter, and the securities clearance staff has been made aware of the importance of following established procedures. Should you experience any other problems or concerns please do not hesitate to contact me at 415/622-5660.

Sincerely,


Brian D. Hagland
Sr. Securities Officer

Brian D. Hagland
Sr. Securities Officer

Securities Clearance
Services Department 3298
Bank Investment
Securities Division



BankAmerica
Capital Markets Group

555 California Street
San Francisco, CA 94104
Box 37003 (94137)
415/622-5660

Bank of America National Trust and Savings Association
Securities Services Division Box 37099 San Francisco, California 94137

EXHIBIT 3

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APPENDIX A

SUMMARY OF COMPLIANCE QUESTIONS FOR REVIEW OF DECEMBER 1986 AND JANUARY AND JULY 1987 INVESTMENT TRANSACTIONS OF THE CITY AND THE REDEVELOPMENT AGENCY

<u>Compliance Question</u>	<u>Based on Sample Review of Finance Documentation Did all Transactions Meet Criteria?</u>
A. PREQUALIFICATION OF DEALERS	
1. Is the Dealer (1) on the list of Government Security Dealers Reporting to the Market Reports Division of Federal Reserve, or does the dealer meet the required Keefe, Bruyette and Woods rating?	YES
2. Has the Dealer or Bank filed an acknowledgement of receipt and review of the City's Investment Policy with Treasury?	NO (2)
3. Have Financial Statements been filed with Treasury?	YES
4. Do the Financial Statements include a Balance Sheet and a Profit and Loss Statement?	YES (3)
5. Are the Financial Statements current?	YES
6. Has Treasury reviewed the Financial Statements?	NO
7. Has a Services Agreement been executed?	NO

(1) Includes banks and savings and loans acting as dealers. Treasury accepts a Keefe, Bruyette and Woods rating of "B", or "C" for selected major California banks, in lieu of primary dealer status for banks and savings and loans.

(2) Finance mailed copies of the revised Investment Policy to banks and dealers on November 3, 1987, the day the City Council approved it.

(3) The Investment Policy has been revised to allow the City to deal with private partnership dealers who normally do not provide Profit and Loss Statement as along as they meet established criteria.

APPENDIX A

SUMMARY OF COMPLIANCE QUESTIONS
FOR REVIEW OF DECEMBER 1986 AND JANUARY AND
JULY 1987 INVESTMENT TRANSACTIONS
OF THE CITY AND THE REDEVELOPMENT AGENCY

<u>Compliance Question</u>	<u>Based on Sample Review of Finance Documentation Did all Transactions Meet Criteria?</u>
B. PROVISIONS APPLYING TO ALL PURCHASES	
1. Purchase is of an approved instrument?	YES
2. Purchase maturity is within policy limits for instrument?	YES
3. Wire transfer of funds initiated by employee other than employee initiating investment?	YES
4. Wire transfer of funds carried out according to the terms of preformatted wire transfer letter?	YES
C. PORTFOLIO MIX	
1. Is within Policy limits for category of instruments?	YES
2. Total with a single issuer, other than government issues:	
a) Is within 10% of total portfolio, unless an overnight repo?	YES
b) For uninsured-uncollateralized issues, is within 5% of total portfolio?	YES
D. TIME DEPOSITS - BANKS AND SAVINGS AND LOANS	
1. Bank or savings and loan is located in San Jose area (Santa Clara County)?	NONE

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SUMMARY OF COMPLIANCE QUESTIONS FOR REVIEW OF DECEMBER 1986 AND JANUARY AND JULY 1987 INVESTMENT TRANSACTIONS OF THE CITY AND THE REDEVELOPMENT AGENCY

<u>Compliance Question</u>	<u>Based on Sample Review of Finance Documentation Did all Transactions Meet Criteria?</u>
2. If not San Jose area, is it a minority bank?	NONE
3. Is a Contract for Public Funds Deposit on file?	NONE
4. Is a Waiver for Collateralization on file (for insured portion)?	NONE
5. For uninsured portion (over \$100,000), is the deposit with a bank or savings and loan with a Keefe, Bruyette and Woods rating of "B" or better, unless a "selected California bank" (Bank of America or Wells Fargo) rated "C" or better?	NONE
 E. U. S. GOVERNMENT AGENCY ISSUES	
1. Is issue by one of the following: <ul style="list-style-type: none"> o Federal Farm Credit Bank; o Federal Home Loan Bank (including FHLMC) or o Federal National Mortgage Association? 	YES
 F. REPURCHASE AGREEMENTS	
1. Collateral is U.S. Treasury or Government Agency issue approved for purchase by Policy?	YES
2. If overnight, collateral is equal to 100% of the repurchase agreement's face value?	NO(1)

(1) In one instance in January 1987 a Redevelopment Agency repurchase agreement acquisition was under-collateralized.

APPENDIX A

SUMMARY OF COMPLIANCE QUESTIONS FOR REVIEW OF DECEMBER 1986 AND JANUARY AND JULY 1987 INVESTMENT TRANSACTIONS OF THE CITY AND THE REDEVELOPMENT AGENCY

<u>Compliance Question</u>	<u>Based on Sample Review of Finance Documentation Did all Transactions Meet Criteria?</u>
3. If other than overnight, collateral is marked-to-market on a daily basis and maintained equal to 100% of the repurchase agreement's face value; or is sufficiently in excess of the repurchase agreements face value?	NONE
G. REVERSE REPURCHASE	NONE
H. BANKER'S ACCEPTANCES	
1. Is the issuer a bank or savings and loan with a Keefe, Bruyette and Woods rating of "B" or better, unless a "selected major California bank" (Bank of America or Wells Fargo) rated "C" or better?	YES
I. NEGOTIABLE CERTIFICATES OF DEPOSIT	
1. Is the issuer a bank or savings and loan with a Keefe, Bruyette and Woods rating of "A/B" or better?	YES
J. COMMERCIAL PAPER	
1. Is this a domestic corporation?	YES
2. Does this institution have the highest rating by Moody's or Standard and Poor's?	YES
3. Does this institution have total assets of \$500,000,000 or more?	YES
4. Does this institution have an "A" rating or higher on its own indebtedness other than its commercial paper?	YES

APPENDIX A

SUMMARY OF COMPLIANCE QUESTIONS
FOR REVIEW OF DECEMBER 1986 AND JANUARY AND
JULY 1987 INVESTMENT TRANSACTIONS
OF THE CITY AND THE REDEVELOPMENT AGENCY

<u>Compliance Question</u>	<u>Based on Sample Review of Finance Documentation Did all Transactions Meet Criteria?</u>
K. SAFEKEEPING-TREASURY PROCEDURES	
1. Person initiating release of securities is not same person initiating sale?	NONE
2. Written confirmation for release of City-owned securities was transmitted to Safekeeper within 5 working days of telephone instructions.	NONE
L. SAFEKEEPING - SECURITY/COLLATERAL HELD	
1. Collateral held by a Safekeeping Agent under the terms of a Safekeeping Agreement with the City?	NO
2. For securities serving as collateral for a repurchase agreement which are not held by a Safekeeping Agent, are the securities held by a third party custodian with a Safekeeping Agreement with the City?	NONE
3. For uninsured/collateralized Time Deposits in a savings and loan, is collateral held by the Federal Home Loan Bank?	NONE

APPENDIX A

SUMMARY OF COMPLIANCE QUESTIONS
FOR REVIEW OF DECEMBER 1986 AND JANUARY AND
JULY 1987 INVESTMENT TRANSACTIONS
OF THE CITY AND THE REDEVELOPMENT AGENCY

<u>Compliance Question</u>	<u>Based on Sample Review of Finance Documentation Did all Transactions Meet Criteria?</u>
4. For uninsured/collateralized Time Deposits in a bank, is collateral held in the City's name in:	
a) The issuing banks' trust department, provided the bank has a Safekeeping Agreement with the City, or	NONE
b) In the San Francisco Federal Reserve Bank?	NONE
M. REPORTING	
1. Exceptions reported to Finance Committee?	YES
<u>OTHER AREAS</u>	
1. Was sale necessary to meet cash needs?	NONE

APPENDIX B

INVESTMENT COMPLIANCE REVIEW
SUMMARY OF IMPLEMENTATION STATUS
FOR PRIOR RECOMMENDATIONS

<u>Recommendation</u>	<u>Status</u>
<u>REVIEW OF SEPTEMBER 1985 INVESTMENTS</u>	
<u>Recommendation #1</u>	
Treasury staff utilize MONEymax in managing the portfolio and making investment decisions by: running a portfolio profile daily or on each day when purchases, sales or maturities occur; and using the portfolio profile report in making investment decisions. (Priority 1)	Implemented.
<u>Recommendation #2</u>	
Treasury staff insure that entry into MONEymax is timely and accurate by: entering transaction data on the date that the transaction occurs; running machine numbered, logged and dated batch reports for all entries; and reviewing batch reports for accuracy. (Priority 1)	Implemented.
<u>Recommendation #3</u>	
Finance enhance staff's ability to utilize MONEymax by: providing comprehensive training for employees in the use of MONEymax; and preparing a simplified instruction manual on the use of MONEymax for Finance employees. (Priority 2)	Training will be on-going. Implemented.
<u>Recommendation #4</u>	
Treasury staff advise Finance management of portfolio status on a timely basis by distributing a copy of the portfolio profile report in Recommendation #1 to the Treasurer, Chief of Accounting and the Finance Director. (Priority 1)	Implemented.

APPENDIX B

INVESTMENT COMPLIANCE REVIEW
SUMMARY OF IMPLEMENTATION STATUS
FOR PRIOR RECOMMENDATIONS

<u>Recommendation</u>	<u>Status</u>
<u>Recommendation #5</u>	
Treasury staff prepare revenue vouchers for maturities, sales and interest payments on the date funds are deposited or payment is received. (Priority 1)	Implemented.
<u>Recommendation #6</u>	
Treasury staff maintain documentation to verify information used each day in making investment decisions, including the portfolio profile report and all cash flow information. (Priority 2)	Implemented.
<u>Recommendation #7</u>	
Finance complete procedures regarding prequalification of financial institutions.	Included in October 1985 Investment Compliance Review Recommendation #3 which is still outstanding.
<u>Recommendation #8</u>	
Treasury document reasons for sales.	Implemented.
<u>Recommendation #9</u>	
Accounting complete improvements in reconciliation procedures.	Included in October 1985 Investment Compliance Review Recommendation #7 and 12 which have been implemented.

APPENDIX B

INVESTMENT COMPLIANCE REVIEW
SUMMARY OF IMPLEMENTATION STATUS
FOR PRIOR RECOMMENDATIONS

<u>Recommendation</u>	<u>Status</u>
<u>REVIEW OF OCTOBER 1985 INVESTMENTS</u>	
<u>Recommendation #1</u>	
Finance comply with Policy requirements to execute formal safekeeping agreements with the City and Redevelopment Agency's Custodial Agents to assure that the City's interest in securities is adequately perfected. (Priority 1)	The City has banking services agreement with the Security Pacific National Bank. This agreement includes custodial services provisions. On the other hand, Redevelopment Agency has proposed that its safekeeping services be merged with the City's safekeeping services agreement with the Security Pacific National Bank. The Finance Committee approved the proposal on 12/01/87. Finance Department will also meet with the Redevelopment Agency to discuss its banking services.
<u>Recommendation #2</u>	
Treasury staff comply with Policy requirements to maintain collateral at 100% of the repurchase agreement's face value, marked-to-market value daily, or sufficiently in excess of the agreement's face value. (Priority 1)	Implemented.
<u>Recommendation #3</u>	
Finance comply with Policy requirements to establish procedures to evaluate and monitor dealer financial condition and execute formal master repurchase agreements and services agreements with dealers. (Priority 1)	Evaluation procedures are in draft form. Evaluating the dealer financial condition will be part of the regular investment processing procedure beginning November 15, 1987. Also, Finance mailed copies of the final draft of the Master Repurchase Agreement to dealers on October 2, 1987. Target date for implementing agreement is December 1, 1987. As of December 3, 1987, ten responses have been received. All responses contained comments that need review by the City Attorney.

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INVESTMENT COMPLIANCE REVIEW
SUMMARY OF IMPLEMENTATION STATUS
FOR PRIOR RECOMMENDATIONS

<u>Recommendation</u>	<u>Status</u>
<u>Recommendation #4</u> Treasury establish guidelines for repurchase agreements which 1) allow substitution of securities only on an exception basis, and 2) limit the number of securities used as collateral. Treasury document reasons for exceptions to the guidelines. (Priority 1)	Implemented.
<u>Recommendation #5</u> Finance obtain clarification from the Private Sector Investment Committee regarding the issues of repurchase agreement collateral, issuer percentages, and financial institution qualifications. (Priority 2)	Implemented.
<u>Recommendation #6</u> Finance include in its Monthly Investment Report all investments which do not comply with Policy provisions. Finance should indicate which investments are subject to on-going review for potential sale. (Priority 2)	Implemented.
<u>Recommendation #7</u> Accounting ensure that safe-keeping receipts are promptly received and reconciled. (Priority 1)	Implemented.
<u>Recommendation #8</u> Treasury establish data entry standards to ensure the accuracy of MONEYMAX entry, including adequate issuer identification. (Priority 1)	Implemented.

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INVESTMENT COMPLIANCE REVIEW
SUMMARY OF IMPLEMENTATION STATUS
FOR PRIOR RECOMMENDATIONS

<u>Recommendation</u>	<u>Status</u>
<u>Recommendation #9</u> Treasury enter the dealer's name and securities held as collateral for repurchase agreements into the MONEYMAX system. (Priority 1)	Implemented.
<u>Recommendation #10</u> Treasury document daily investment strategy and purchase decisions. (Priority 2)	Implemented.
<u>Recommendation #11</u> Treasury segregate the functions of investing funds and receiving investment income. (Priority 1)	Alternative procedure was implemented. The Chief of the Treasury or designee not involved in investment activities approves investment revenue vouchers. Further follow-up required.
<u>Recommendation #12</u> Finance establish additional procedures to ensure that controls are functioning and written verification of purchases and sales is complete and timely. Specifically, procedures need to be established to 1) monitor compliance with Policy provisions regarding release of funds or securities, 2) provide for 24 hour preparation and mailing of confirmations, 3) implement pre-numbered and controlled confirmation documents, and 4) date stamp and reconcile dealer, safekeeping, debit and credit advices as received. (Priority 2)	Implemented.

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INVESTMENT COMPLIANCE REVIEW
SUMMARY OF IMPLEMENTATION STATUS
FOR PRIOR RECOMMENDATIONS

<u>Recommendation</u>	<u>Status</u>
<u>REVIEW OF NOVEMBER-DECEMBER 1985 INVESTMENTS</u>	
<u>Recommendation #1:</u>	
Finance obtain a legal opinion to determine requirements for an independent third party custodian for securities involved in City investments. (Priority 2)	Implemented.
<u>Recommendation #2:</u>	
Finance incorporate a clause in the proposed City-initiated dealer agreements to supersede any prior service or master repurchase agreements with the dealer. (Priority 2)	Finance will include in its cover memo for signed master repurchase agreement a statement that any prior service or master repurchase agreements shall have been superseded. Further follow-up is required.
<u>Recommendation #3:</u>	
Finance document its Policy interpretations. (Priority 2)	Implemented.
<u>Recommendation #4:</u>	
Finance prepare a compilation and analysis of State and Federal laws applicable to the investment program. (Priority 2)	Implemented.

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INVESTMENT COMPLIANCE REVIEW
SUMMARY OF IMPLEMENTATION STATUS
FOR PRIOR RECOMMENDATIONS

<u>Recommendation</u>	<u>Status</u>
<u>REVIEW OF MARCH-APRIL 1986 INVESTMENTS</u>	
<u>Recommendation #1:</u>	
Finance obtain Private Sector Panel approval of alternative dealer financial information requirements and amend the the Investment Policy accordingly. (Priority 2)	Implemented.
<u>Recommendation #2:</u>	
Finance include in the Investment Procedures specific instructions regarding all Policy provisions. These instructions should address 1) all required dealer financial information requirements, 2) dealer acknowledgement of the City's Investment Policy, 3) pre-formatted wire instructions for banks, and 4) instrument and issuer ratings. (Priority 2)	Implemented.
<u>Recommendation #3:</u>	
Finance report all technical exceptions to the City's Investment Policy to the Finance Committee in its Monthly Investment Report. (Priority 2)	Implemented.

APPENDIX B

INVESTMENT COMPLIANCE REVIEW
SUMMARY OF IMPLEMENTATION STATUS
FOR PRIOR RECOMMENDATIONS

REVIEW MAY-JUNE 1986 INVESTMENTS

<u>Recommendation</u>	<u>Status</u>
<u>Recommendation #1:</u> Treasury log the dates confirmations, which outline instructions and details for transactions entered into over the telephone, were mailed to banks.	Implemented.
<u>Recommendation #2:</u> Redevelopment Accounting date-stamp dealer confirmations, safekeeping receipts/releases, and debit and credit advices as received. (Priority 2)	Implemented.